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TAX INFORMATION RELEASE NO. 2018-06

Re: General Excise Tax Exemption for Contracting and Services Exported Outside the State;
Sourcing of Income from Contracting and Services

This Tax Information Release (TIR) discusses the sourcing and apportionment of income from contracting or services for purposes of the general excise tax (GET) and the exemption for contracting or services exported outside the State pursuant to section 237-29.53, Hawaii Revised Statutes (HRS), and sections 18-237-29.53-01 to 18-237-29.53-13, Hawaii Administrative Rules (HAR). These administrative rules were adopted and made effective on March 29, 2018.

This TIR provides general information and is not intended to replace the law or change its meaning. If any conflict exists between this TIR and the HRS and/or HAR, the HRS and/or HAR shall be controlling.

Historical Background

Prior to the enactment of the exported services exemption, section 237-29.53, HRS, the Department sourced and apportioned gross income from services based on a "place of performance" test. Under the place of performance test, a taxpayer was subject to GET if the taxpayer was physically in the State at the time the service was performed.

The sourcing of income was necessary pursuant to section 237-21, HRS, which provides:

If any person . . . is engaged in business both within and without the State . . . and if under the Constitution or laws of the United States . . . the entire gross income of such person cannot be included in the measure of this tax, there shall be apportioned to the State and included in the measure of the tax that portion of the gross income which is derived from activities within the State, to the extent that the apportionment is required by the Constitution or laws of the United States.

Because the State did not offer a credit or offset for taxes paid to another state, there was a risk that gross income would be subject to double taxation in violation of the U.S. Commerce

Clause.¹ See Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (tax must be “fairly apportioned” to comport with U.S. Commerce Clause); see also Tyler Pipe Industries, Inc. v. Washington State Dep’t of Revenue, 483 U.S. 232, 248 (1987) (credit provision for tax paid to another state would cure discrimination in violation of U.S. Commerce Clause).

Act 70, Session Laws of Hawaii 1999, which became effective on January 1, 2000, created section 237-29.53, HRS, which provides a GET exemption for contracting or services used or consumed outside the State. Act 70 therefore superseded the “place of performance” test and replaced it with a “used or consumed” test. Under the used or consumed test, a taxpayer is subject to GET if the service is used or consumed in the State, and conversely, is exempt from GET if the service is used or consumed outside the State.

Exported Services Exemption

To determine where contracting or services are used or consumed for purposes of section 237-29.53, HRS, taxpayers will need to determine which one of the nine categories listed in sections 18-237-29.53-03 through 18-237-29.53-11, HAR, the contracting or services fall under and follow the corresponding sourcing rule. If contracting or services are used or consumed both in and outside of the State, the taxpayer must apportion gross income using any reasonable method, provided that it is consistently used by the taxpayer and supported by verifiable data.

1. Contracting

Contracting, as defined in section 237-6, HRS, is used or consumed where the real property to which the contracting activity pertains is located. HAR § 18-237-29.53-03.

2. Services Related to Real Property

Services related to real property, including property management, real estate sales, real estate inspections, and real estate appraisals, are used or consumed where the real property is located. HAR § 18-237-29.53-04.

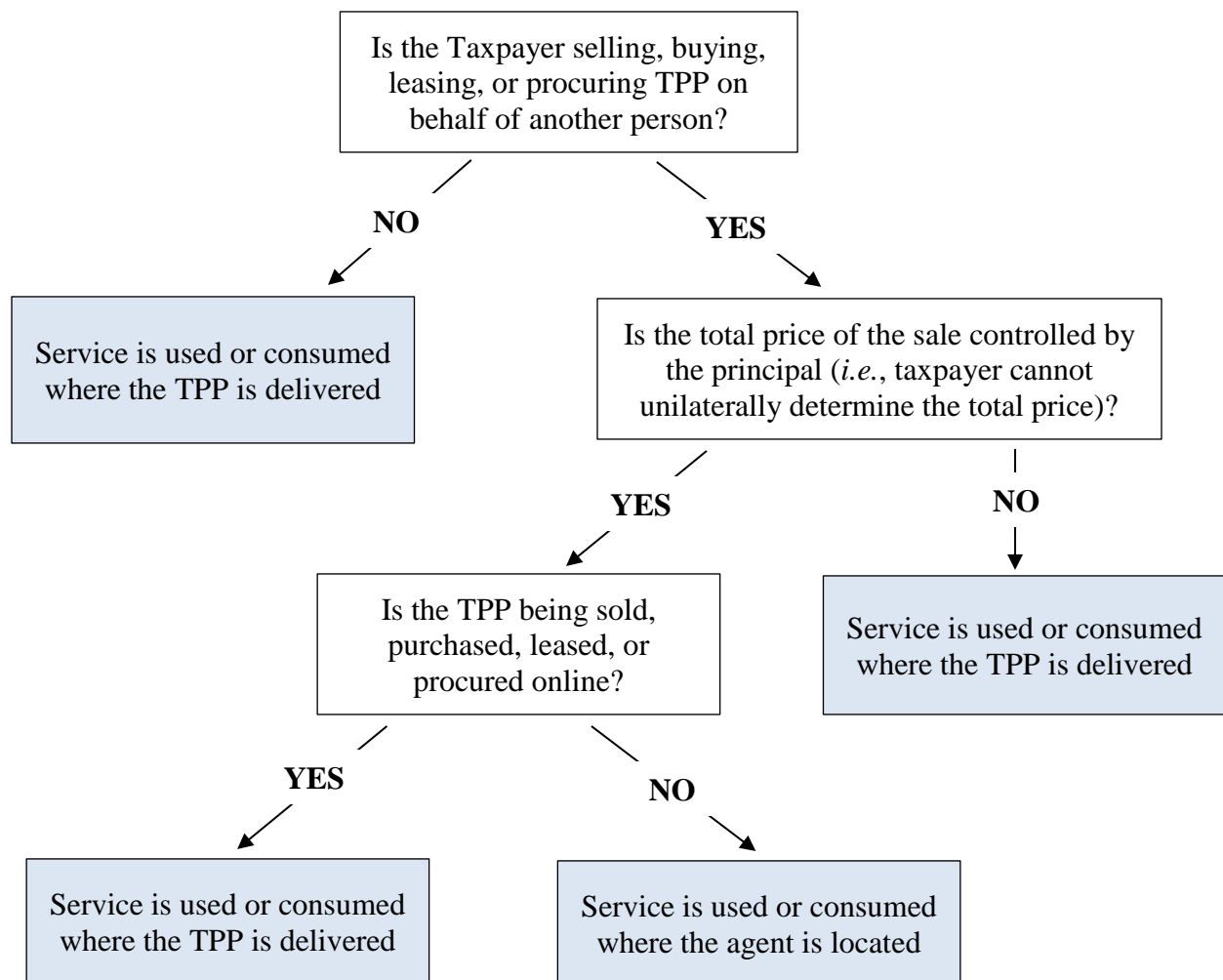
¹ Act 98, Session Laws of Hawaii 2002, amended section 237-22, HRS, by providing an offset for taxes paid to another state.

3. Services Related to Tangible Personal Property (TPP)

Services related to TPP, including inspection, appraisal, testing, and repair, are used or consumed where the TPP is delivered after the services are performed. HAR § 18-237-29.53-05.

Services performed by a commissioned agent, however, have different sourcing rules. A taxpayer is a commissioned agent, with respect to TPP, if the taxpayer sells, buys, leases, or procures TPP on behalf of a principal with the principal's assent for a predetermined fee and the total price of the sale is controlled by the principal. HAR § 18-237-29.53-01. If the commissioned agent sells, purchases, leases, or procures TPP online (exclusively through a website or app without any in-person contact), the commissioned agent's service is used or consumed where the TPP is delivered. HAR § 18-237-29.53-10(a)(1). If the TPP is not sold, purchased, leased, or procured online, the commissioned agent's service is used or consumed where the agent is located at the time the service is performed. HAR § 18-237-29.53-10(a).

The sourcing rules for services relating to TPP are illustrated in the following diagram:



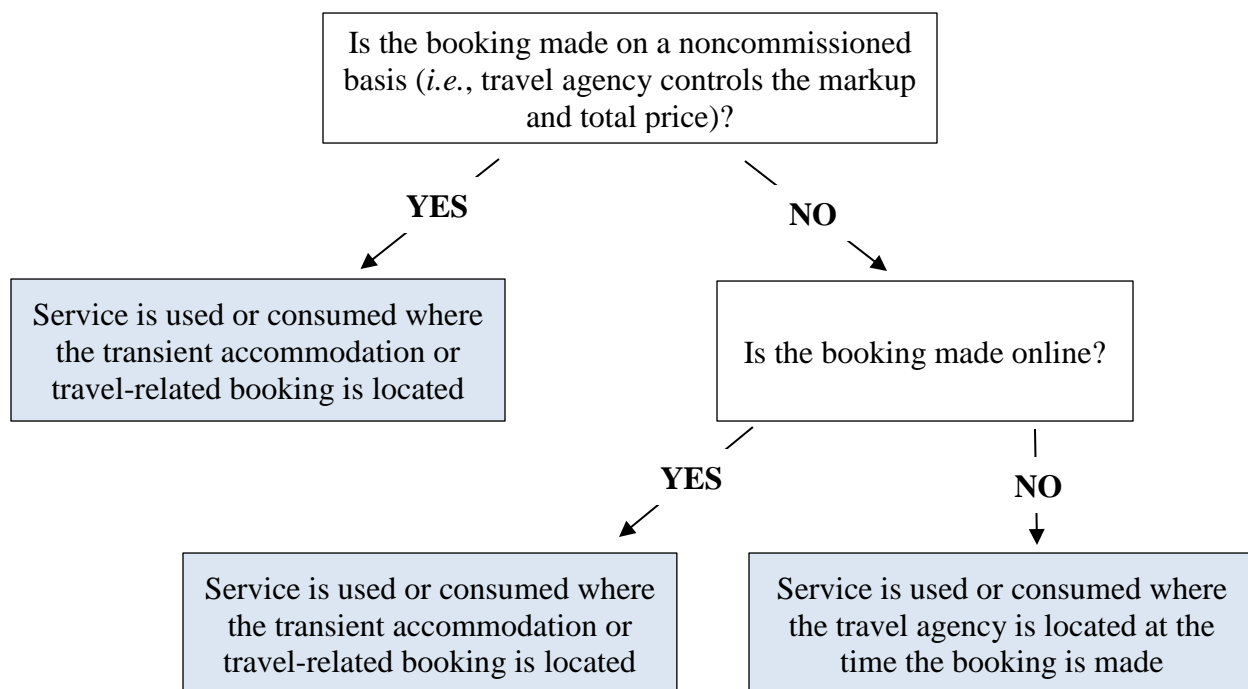
4. Booking Services by a Travel Agency or Tour Packager

Income from the sale, booking, or arrangement of transient accommodations or travel-related bookings (including tours, excursions, transportation, rental vehicles, shows, dining, spa services, and other reservations or bookings) by a travel agency or tour packager is sourced based on whether the transaction was booked on a commissioned or noncommissioned basis and whether the booking was made online.

A booking is made on a commissioned basis if the travel agency or tour packager books the transient accommodation or travel-related booking on behalf of a principal with the principal's assent for a predetermined fee and the total price of the booking is controlled by the principal. HAR § 18-237-29.53-01. A booking is made on a noncommissioned basis if the travel agency or tour packager has a contract with an operator of a transient accommodation or operator of a travel-related booking that specifies the rate the operator will receive for a booking and the travel agency or tour packager may unilaterally determine the mark-up and the total price charged to the customer. Id.

Income from bookings made on a noncommissioned basis is sourced to where the transient accommodation or travel-related booking is located. HAR § 18-237-29.53-06. Similarly, income from bookings made online (exclusively through a website or app without any in-person contact) on a commissioned basis is sourced to where the transient accommodation or travel-related booking is located. HAR § 18-237-29.53-10(a)(3). Income from bookings made on a commissioned basis that are not completed online is sourced to where the travel agency or tour packager is located at the time the booking is made. HAR § 18-237-29.53-10(a).

The sourcing rules for travel agencies and tour packagers are illustrated in the following diagram:

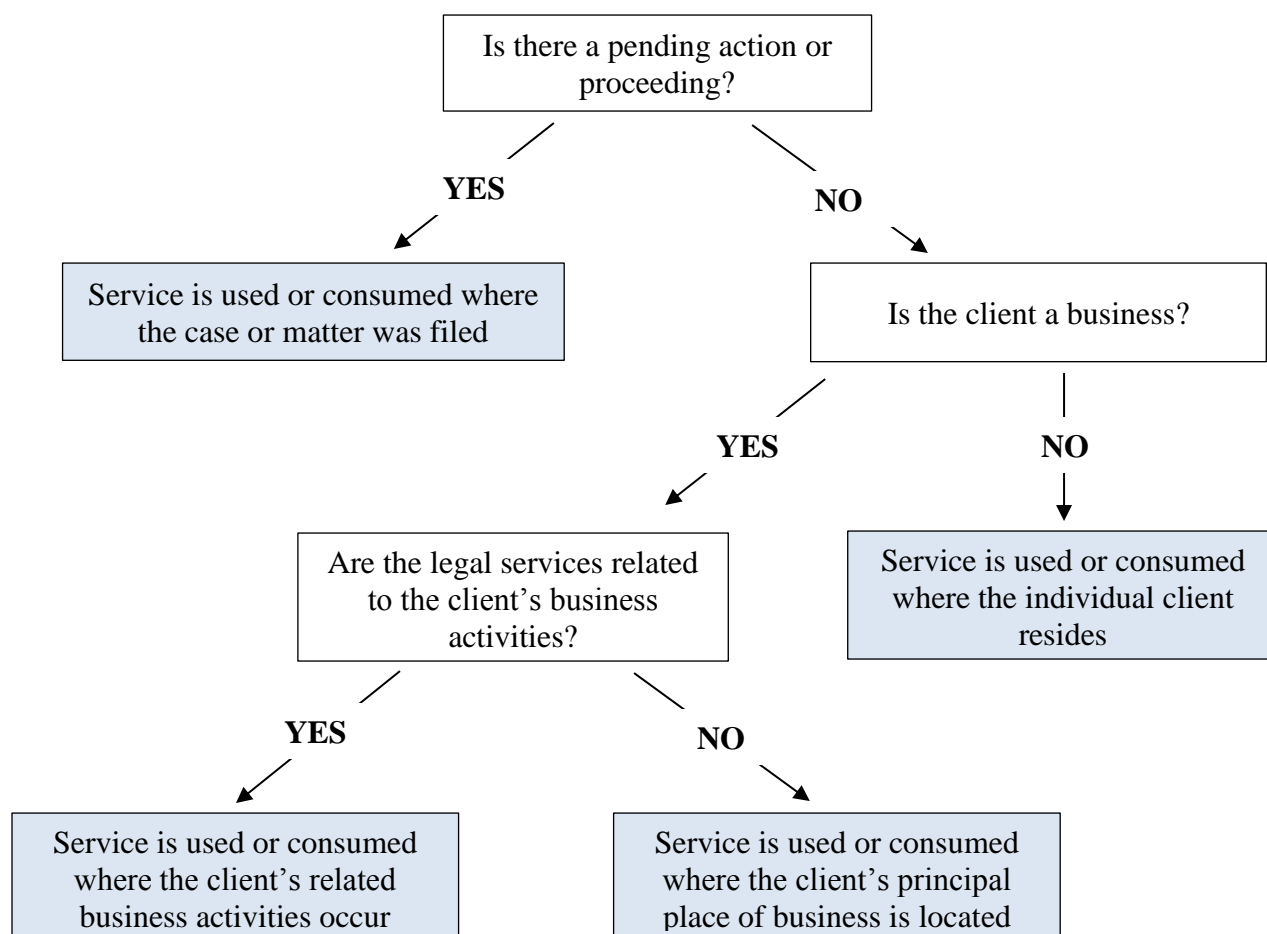


5. Legal Services

Legal services provided to a party in a judicial or administrative action or proceeding, arbitration, mediation, or other method of dispute resolution are used or consumed where the case or matter is filed. HAR § 18-237-29.53-07.

If an action or proceeding is not pending, or if the customer is not a party to the action or proceeding, income from legal services is sourced based on whether the client is an individual, business, or military or government. HAR § 18-237-29.53-11. Legal services provided to an individual are used or consumed where the individual resides. HAR § 18-237-29.53-11(a)(3). Legal services provided to the military or government are used or consumed where the benefit of the services is received. HAR § 18-237-29.53-11(a)(4). If legal services are provided to a business and the legal services relate to the client's business activities, the legal services are used or consumed where the client's related business activities occur. HAR § 18-237-29.53-11(a)(1). If legal services are provided to a business and the legal services are unrelated to the client's business activities, the legal services are used or consumed where the client's principal place of business is located. HAR § 18-237-29.53-11(a)(2).

The sourcing rules for legal services are illustrated in the following diagram:



6. Debt Collection

Debt collection services are used or consumed where the collection actions take place. HAR § 18-237-29.53-08.

7. Services Requiring the Customer to be Physically Present

Services that require the customer to be physically present at the time the services are performed are used or consumed where the services are performed. HAR § 18-237-29.53-09. This rule does not apply to contracting, services related to real property, services related to TPP, services provided by a travel agency or tour packager, legal services, and debt collection services. Id.

8. Sale, Purchase, or Procurement of Services by a Commissioned Agent

Income of a commissioned agent who sells, buys, or procures services online (exclusively through a website or app without any in-person contact) is sourced to where the transacted services are performed. HAR § 18-237-29.53-10(a)(2). If the transacted services are not sold, purchased, or procured online, the commissioned agent's services are used or consumed where the agent is located at the time the agent's services are performed. HAR § 18-237-29.53-10(a).

9. Other Services Not Covered Above

All other services that are not covered in the rules above are sourced as follows:

- Services provided to individuals are used or consumed where the individual resides;
- Services provided to the military or federal, state, or local government are used or consumed where the benefit of the services are received;
- Services provided to a business that relate to the customer's business activities are used or consumed where the customer's related business activities occur;
- Services provided to a business that are unrelated to the customer's business activities are used or consumed where the customer's principal place of business is located.

HAR § 18-237-29.53-11.

A summary of the sourcing rules discussed above may be found in the attached table. For more information, please contact the Rules Office at (808) 587-1530 or by email at Tax.Rules.Office@hawaii.gov.

LINDA CHU TAKAYAMA
Director of Taxation

Summary of GET Sourcing Rules Under Section 237-29.53, HRS

ACTIVITY	WHERE USED OR CONSUMED
1. Contracting	
All contracting, as defined in section 237-6, HRS	Location of real property
2. Services relating to real property	
All services that relate to real property	Location of real property
3. Services relating to TPP	
If taxpayer is a commissioned agent (<i>i.e.</i> , selling, buying, leasing, or procuring TPP on behalf of a principal and the total price of the sale is controlled by the principal) and	
The transaction is made online	Place of delivery of TPP
The transaction is not made online	Location of agent
All other services that relate to TPP	Place of delivery of TPP
4. Booking services by travel agency or tour packager	
If the booking is made on a noncommissioned basis (<i>i.e.</i> , travel agency controls markup and total price)	Location of transient accommodation or travel-related booking
If the booking is made on a commissioned basis (<i>i.e.</i> , travel agency does not control markup and total price) and	
The booking is made online	Location of transient accommodation or travel-related booking
The booking is not made online	Location of travel agent at the time the booking is made
5. Legal services	
If there is a pending action or proceeding	Where the case was filed
If there is no pending action or proceeding and	
The client is an individual	Client's residence
The client is the military or government	Where the benefit of the service is received
The client is a business and	
The legal services are related to the client's business activities	Where the related business activities occur/occurred
The legal services are unrelated to the client's business activities	The business' principal place of business

6. Debt collection	
If the service involves enforcement of a money judgment or collection of a debt	Location of collection action
7. Services requiring customer to be physically present	
Services that require the customer to be physically present	Where service is performed
8. Sales of services by commissioned agent	
If taxpayer is selling, purchasing, or procuring services, the total price of the sale is controlled by the principal, and	
The sale is completed online	Where the transacted service is performed
The sale is not completed online	Location of agent
9. Other services not covered above	
If the customer is an individual	Customer's residence
If the customer is the military or government entity	Where the benefit of the service was received
If the customer is a business and	
The service relates to the customer's business activities	Where the customer's related business activities occur
The service does not relate to the customer's business activities	Customer's principal place of business